IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No.

IN THE MATTER

of

A. L. HARTRIDGE COMPANY INCORPORATED,

Bankrupt.

INDEMNITY INSURANCE COMPANY OF NORTH AMERICA,

Petitioner,

—against—

BAYARD I. REISLEY, as Trustee in Bankruptcy of A. L. HARTRIDGE COMPANY, INCORPORATED, Bankrupt,

Respondent.

BRIEF IN SUPPORT OF PETITION

Statement of the Case

A summary statement of the facts is given in the petition pages 2-4 above.

Grounds of Jurisdiction

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. Sec. 347) and Section 24 (c) of the Bankruptcy Act.

Specification of Errors

The petitioner will urge that the Circuit Court of Appeals for the Second Circuit erred:

(1) In entertaining the appeal of the trustee from the decision of the District Court denying his application for a rehearing.

(2) In holding that the refusal of the District Court to grant the rehearing was an abuse of discretion.

(3) In holding that the Referee can revise an order in a reclamation proceeding at any time during the pendency of the bankruptcy proceedings.

(4) In sustaining the District Court and Referee in their refusal to direct the trustee to pay to petitioner, as beneficiary, the balance of the trust fund held by him.

(5) In sustaining the District Court that the decision of the Court of Appeals of the State of New York in the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.*, 288 N. Y. 452, ruled that Section 36a of the Lien Law of the State of New York can under no circumstances give rise to a trust in favor of the beneficiaries designated therein.

Statutes Involved

The statutes involved are set forth in the brief.

Opinions Below

The opinions of the Circuit Court are reported in 153 F. (2d) 296 and are contained in the record. The original opinion appears at (R. 24-28) and the opinion on the rehearing (R. 40-42).

POINT I

The Circuit Court of Appeals was without jurisdiction to entertain the trustee's appeal.

An order denying an untimely petition for rehearing because a prior similar petition for a rehearing was adjudged untimely does not constitute a reconsideration of the original order so as to extend the time for appeal therefrom.

The order which the trustee seeks to have reconsidered is dated April 14, 1942. Substantially, that order decreed that the monies collected by the trustee from Grant constituted a trust fund, as defined in Section 36a of the Lien Law of the State of New York, and the trustee was directed to pay to the petitioner the sum of $5,263.40. The referee made the following finding in connection with his denial of the trustee's application made in 1945:

"Conclusions of Law

1. The cross petition * * * by the trustee insofar as it prays for reconsideration and reversal of the order dated April 14, 1942 * * * must be denied on the ground that a previous application * * * to reconsider and set aside such order * * * has been denied and such decision is res adjudicata" (R. 17).

Obviously the merits of the order of April 14, 1942 were not considered. The referee simply determined that since an earlier application had been denied because it was untimely he refused to entertain a second application.

The decision of District Judge Rifkind confirming the referee's order states this very clearly:

"Even if I assume that I am not bound by the decision of Judge Mandelbaum, from which no review by the Court of Appeals has been sought, and that the doctrine of res adjudicata does not apply, nevertheless, it would seem clear that an application which was tardy in September, 1943, cannot have become timely on March 8, 1945, when the trustee's cross petition was filed" (R. 8).

In the case of *Bernards* v. *Johnson,* 314 U. S. 19, 31, on facts almost identical to the present case this Court held:

"The Court dismissed the petition for review. The commissioner had denied the petition of January 4, 1937, on the sole ground 'that all the matters and things set out in said petition have been previously adjudicated and no review thereof has been had, or if review was taken, such actions of the Referee have been approved on review', and that 'all matters and things in said petition alleged have heretofore been considered upon petition filed by said bankrupts and decided adversely to said bankrupts, and said orders have all become final and conclusive.' The order affirming the action of the commissioner did not deal with the merits. The Court clearly affirmed the commissioner's refusal to consider the petition for the reason stated by him.

In dismissing the petition of January 15, 1937, and the motion of April 13, 1938, the Court made findings of fact and stated conclusions of law covering both. It entered what it denominated an 'order and decree' with respect to both, and, as above noted, dismissed both the petition and the motion, on the stated ground that all issues therein raised had been finally adju-

dicated and no review or appeal had been timely sought or taken.

If the respondents had not cross-petitioned for affirmative relief, the District Court need have taken no further action than it did in dismissing the bankrupts' petition and motion. An order denying a petition for rehearing or review, which is dismissed because the petition was filed out of time, without reconsideration of the merits, does not extend the time for appeal from the original order."

Nor does an examination of the grounds for allowing a rehearing enlarge the time for review of the original order. *Pfister* v. *Northern Illinois Finance Corp.*, 317 U. S. 144, 151. There the Court stated:

"On the other hand, where out of time petitions for rehearing are filed and the referee or court merely considers whether the petition sets out, and the facts—if any are offered—support, grounds for opening the original order and determines that no grounds for a re-examination of the original order are shown, the hearing upon or examination of the grounds for allowing a rehearing does not enlarge the time for review of the original order. This result follows from the well-established rule that where an untimely petition for rehearing is filed which is not entertained or considered on its merits the time to appeal from the original order is not extended.

If a consideration of the reasons for allowing a rehearing out of time which are brought forward by the petition for rehearing were sufficient to resurrect the original order, the mere filing of an out of time petition would be enough. Of course, the court must examine the petition to see whether it should be grant-

ed. Indeed the examination given a motion to file such a petition might just as well be said to justify the advancement of the time for review. It is quite true that in a petition for review upon the ground of error in law in the original order, the examination of the grounds of the petition for rehearing is equivalent to a re-examination of this basis of the original decree. But in such a case the order on the petition for review would control. It would show either a refusal to allow the petition for rehearing or a refusal to modify the original order. Cf. *Wayne Gas Co.* v. *Owens-Illinois Co.*, 300 U. S. 131, 137-38. Whether time for appeal would be enlarged or not would depend upon what the order showed the Court did."

POINT II

Equity will not aid one who has slept upon his rights and shows no excuse for his delay.

The trustee seeks reconsideration of an order made on April 14, 1942. The trustee not only did not seek a review by the District Court of the said order but complied with it. No action whatever was taken by the trustee until September 29, 1943 when a creditor of the bankrupt made an application for reconsideration of the said order on the ground of mistake of law. The basis of the said petition was the decision by the Court of Appeals of the State of New York in the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.*, 288 N. Y. 452, 43 N. E. (2d) 486 decided July 29, 1942. The trustee appeared and participated in the hearing based upon the creditor's application and urged the vacatur of the order of April 14, 1942 (R. 16). Upon the denial of the creditor's application by

the Referee a review of the said order was taken to the District Court and on January 14, 1944 the District Court confirmed the Referee. No appeal was taken from that order.

On March 6, 1945 the petitioner made an application to the Referee to vacate an order providing for the payment of a 5% dividend to general creditors and asked for a direction to the trustee that he pay to the petitioner the balance of its claim to the trust funds in his possession. It was not until March, 1945, almost three years after the entry of the original order, in the answer to the petition of March 6, 1945, that the trustee sought a rehearing of the order of April 14, 1942, by interposing a cross-petition to the application made by the insurance company.

The facts in the case of *Price* v. *National Surety Corporation*, 127 F. (2d) 726 were closely akin to the instant case. Holding that a delay of slightly less than two years bars a review of the order appealed from, the Circuit Court of Appeals for the Sixth Circuit in a *per curiam* decision said:

> "This cause was heard on the transcript of the record and briefs of counsel, and on consideration thereof no reversible error appears on the record. Assuming without deciding, that a bill of review is the proper remedy for the relief sought, the court is of the opinion that, under the circumstances in this case, the delay in filing it, from May 18, 1938, to March 18, 1940, showed a lack of due diligence."

Petition for certiorari denied. 316 U. S. 683.

The authorities to support that conclusion are numerous and decisive.

POINT III

The adoption by the Supreme Court of the Rules of Civil Procedure which were made applicable in bankruptcy by General Order XXXVII modified the Rule in the *Wayne Gas Co.* case that a bankruptcy court may revise its judgments at any time during the pendency of the proceedings.

The contention of petitioner is that in a reclamation proceeding, which is in the nature of a civil suit, reconsideration of a final order is governed by Rules 59 and 60. It is true that due to the nature of the grounds upon which the trustee is seeking to have the original order reconsidered he is not entitled to the relief afforded by Section 60. He could have obtained relief under Section 59 had he applied within the time prescribed by that section.

In disregarding the effect of the Rules of Civil Procedure on applications for rehearings, the Circuit Court of Appeals in the instant case is directly in conflict with the Circuit Court of Appeals for the Tenth Circuit. The latter Circuit Court, in the case of *Norris* v. *Camp* (1944), 144 F. (2d) 1, 4, said:

> "Prior to the effective date of General Order No. 37, 11 U. S. C. A. following section 53, a court of bankruptcy had the power, for good reason, to revise its judgments upon seasonable application and before rights had vested on the faith of its action (citing the Wayne United Gas Co. and others). But General Order No. 37 made the Rules of Civil Procedure applicable to proceedings in bankruptcy. Rule 60 (b) of the Rules of Civil Procedure, in part, provides: (quoting Section 60 (b)).

> Since the six months' period had expired before the answer was filed by the city treasurer, we think the lower court had no power to modify the order and final judgment in the composition proceeding under the provisions of Rule 60. This rule, however, does not limit the power of the court to entertain an action to relieve a party from a judgment, order or proceeding. But, after the expiration of six months, the party must apply by bill of review, now designated civil action, to obtain relief from a judgment which itself is final so far as any further steps in the original action are concerned."

Apparently this question was not passed upon by this Court. In the 1945 supplement to Vol. 2, 4th edition of Remington on Bankruptcy there is the following query:

> "Has Federal Rules of Civil Procedure 60 (b) made applicable by General Order XXXVII modified the rule in Wayne United Gas Co. v. Owens-Illinois Gas Co., 300 U. S. 131, 81 L. ed. 557, 57 S. Ct. 382, 33 A. B. R. (N. S.) 1 (1937) that a bankruptcy court may at any time for good reason on seasonable application and before rights have vested revise its judgments?"

The original order of the referee dated April 14, 1942 was not interlocutory but final and appealable. It was a complete and definitive disposition of the cause before the Court. The only provisions in the Rules for the modification or vacation of such an order are found in Rules 59 and 60. The latter is clearly inapplicable. A change in the law by a subsequent decision is neither a clerical mistake nor a mistake of a party. Under the old equity procedure the bill of review served substantially the same

purpose after term as the petition for rehearing served during term and consequently would not lie until the time for filing a petition for rehearing at best. But the grounds that would sustain a bill of review were more limited than those that would sustain a petition for rehearing. Thus a subsequent decision of a higher court changing the law would lay the foundation for a petition for a rehearing but not for a bill of review. Since such a subsequent decision is precisely the ground of the trustee's application, it follows that it cannot be treated as a bill of review. Therefore the present application must be considered as addressed to the exercise of the power of the court under Rule 59.

Rule 6 (c) now abolishes the effect of the expiration of the term on the power of the Court to act. Rule 59 (b) provides a definite time within which a motion for a new trial may be made and Rule 6 (b) forbids the Court to enlarge that time. If it were not thereby intended to make the running of that definite time as conclusive on the power of the Court as was formerly the expiration of the term, there would be no limit on the power of the Court to act and no finality when it did act. A construction which would empower the Court to hear motions long out of time would destroy the rule for by the very act of hearing, the prohibited relief could effectively be granted.

POINT IV

The trustee in bankruptcy cannot refuse to recognize the trust rights of the petitioner because he is protected by judicial immunity from the penal consequences of his acts.

After the decision by the New York Court of Appeals in the *Raymond Concrete* case the only method left for the enforcement of the trust established by that section was recourse to the criminal courts. The funds came into the hands of the trustee after the adjudication and he is protected by his office from the criminal penalties prescribed by that section. The Circuit Court of Appeals for the Second Circuit in a case similar to the present case declared that the trustee would not be permitted to take advantage of his immunity to deprive the beneficiary of a trust of its avails. In the case of *City of New York* v. *Rassner*, 127 F. (2d) 703, the Court stated:

> "If the debtor in possession failed to segregate the taxes collected from vendees, it did so under the control of the court. The city could hardly seek fine or imprisonment of the debtor or its officers for failure to segregate funds—assuming the penal provisions, Administrative Code C 41 Lib N Sec 41-17.0, as amended by Local Laws 1940, p. 362, go that far—because the status of the debtor as under court control would be a defense.
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> Thus stated, it can be seen that we would be condoning improper action by a trustee so long as he could successfully get away with it. As a court of equity, a bankruptcy court can hardly proceed on this assumption."

The decision of the Circuit Court of Appeals in the present case seems to conflict with its prior decision in the above cited case. The Court should have applied the same rule to the instant case.

POINT V

The Courts below in holding that Section 36a of the Lien Law of the State of New York can never give rise to a trust in favor of the beneficiaries designated therein misconstrued the decision of the Court of Appeals of the State of New York in the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.*

A reading of Section 36-a[1] clearly shows that first a right is created; that is, the funds received by a contractor or an owner for the improvement of real property is declared to constitute a trust fund for the benefit of the persons named, and then the section goes on to provide a remedy to enforce compliance therewith.

In the case of *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Company,* 288 N. Y. 452, the plaintiff, a sub-

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1 Section 36-a of the Lien Law of the State of New York prior to the 1942 amendment, provided as follows:

> "The funds received by a contractor from an owner for the improvement of real property are hereby declared to constitute trust funds in the hands of such contractor to be applied first to the payment of claims of subcontractors, architects, engineers, surveyors, laborers and materialmen arising out of the improvement, and to the payment of premiums on surety bond or bonds filed and premiums on insurance accruing during the making of the improvement and any contractor and any officer, director or agent of any contractor who applies or consents to the application of such funds for any other purpose and fails to pay the claims hereinbefore mentioned is guilty of larceny and punishable as provided in section thirteen hundred and two of the penal law."

contractor of a general contractor who was a depositor in the defendant bank, brought a civil suit against the bank to recover from it certain money which the bank had applied on a loan made by it to the contractor on the ground that the money so applied constituted a trust fund for its benefit.

The Court of Appeals reversed the decision of the Appellate Division in favor of the plaintiff and dismissed the complaint. In the course of its opinion, the Court held that Section 36-a of the Lien Law did not create a civil remedy to enforce the trust set up therein. The Court, in its opinion, clearly accepted the trust fund theory created by the statute and directed its opinion solely to the means of enforcement of the right, holding that no new civil remedy was given. Whether a trust arises depends on the facts and circumstances in each particular case. The Court said:

> "* * * Whether the monies in the hands of the contractor are or may be the subject-matter of a trust depends exclusively upon the fact, arising, existing and shifting according to time and circumstance, that the contractor fails to pay the claims mentioned in the section * * *"

The 1942 amendment made the following changes: It added to the catch line "Civil remedy to enforce trust" and at the end of the section the following was added:

> "Such trust may be enforced by civil action maintained as provided in article three-a of this chapter by any person entitled to share in the fund, whether or not he shall have filed, or had the right to file, a notice of lien or shall have recovered a judgment for a claim in connection with the improvement. For the purposes of a civil action only, the trust funds shall include the right of action upon a building loan contract, mortgage or conveyance for moneys due or to become due thereunder to the owner, as well as moneys actually received by him."

The amendment is contained in Chapter 808, Section 2 of the Laws of 1942, effective September 1, 1942.

"* * * It necessarily follows that no trust arises under that section from the mere fact that the contractor received and has in his hands monies in payment on account of a public improvement."

It is therefore apparent that the decision of the Court of Appeals in the *Raymond Concrete* case does not alter the trust nature of the fund received from Grant and does not deprive the petitioner of its rights as a beneficiary thereof upon distribution in bankruptcy.

Section 1302 of the Penal Law[2] deals with the punishment of fiduciaries for converting or misappropriating

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2 Section 1302 of the Penal Law of the State of New York reads as follows:

"Conversion of property held in trust or by virtue of office, larceny; how punished

A person acting as executor, administrator, committee, guardian, receiver, collector or trustee of any description, appointed by a deed, will, or other instrument, or by an order or judgment of a court or officer, who secretes, withholds, or otherwise appropriates to his own use, or that of any person other than the true owner, or person entitled thereto, any money, goods, thing in action, security, evidence of debt or of property, or other valuable thing, or any proceeds thereof, in his possession or custody by virtue of his office, employment, or appointment, is guilty of grand or petit larceny in such degree as is herein prescribed, with reference to the amount of such property; and upon conviction, in addition to the punishment in this article prescribed for such larceny, may be adjudged to pay a fine, not exceeding the value of the property so misappropriated or stolen, with interest thereon from the time of the misappropriation, withholding, or concealment, and twenty per centum thereupon, in addition, and to be imprisoned for not more than five years in addition to the term of his sentence for larceny, according to this article, unless the fine is sooner paid.

So much of the fine authorized in this section to be imposed, as does not exceed the amount or value of the property taken, appropriated, or stolen, with interest thereupon from the time of the commission of the offense, and a reasonable sum to defray the expense of collecting the same, to be fixed by the supreme court, must, when received or collected, be paid to the county treasurer of the county where the conviction was had, for the benefit of the person injured or defrauded, or whose property the offender took, misappropriated, or concealed, or his representative or assignee; and must be paid over to him by the county treasurer, upon the order of the supreme court, made after notice to the district attorney of the county."

property belonging to a trust. If the trust theory upon which the entire Section 36a is founded is destroyed, it is difficult to see how enforcement under the penal provisions could be sustained. This would render the entire legislation negatory. It is apparent that the Court of Appeals never intended to go that far.

CONCLUSION

It is respectfully submitted that the petition for certiorari should be granted.

HENRY K. CHAPMAN,
Counsel for Petitioner.

Dated: April 19th, 1946.